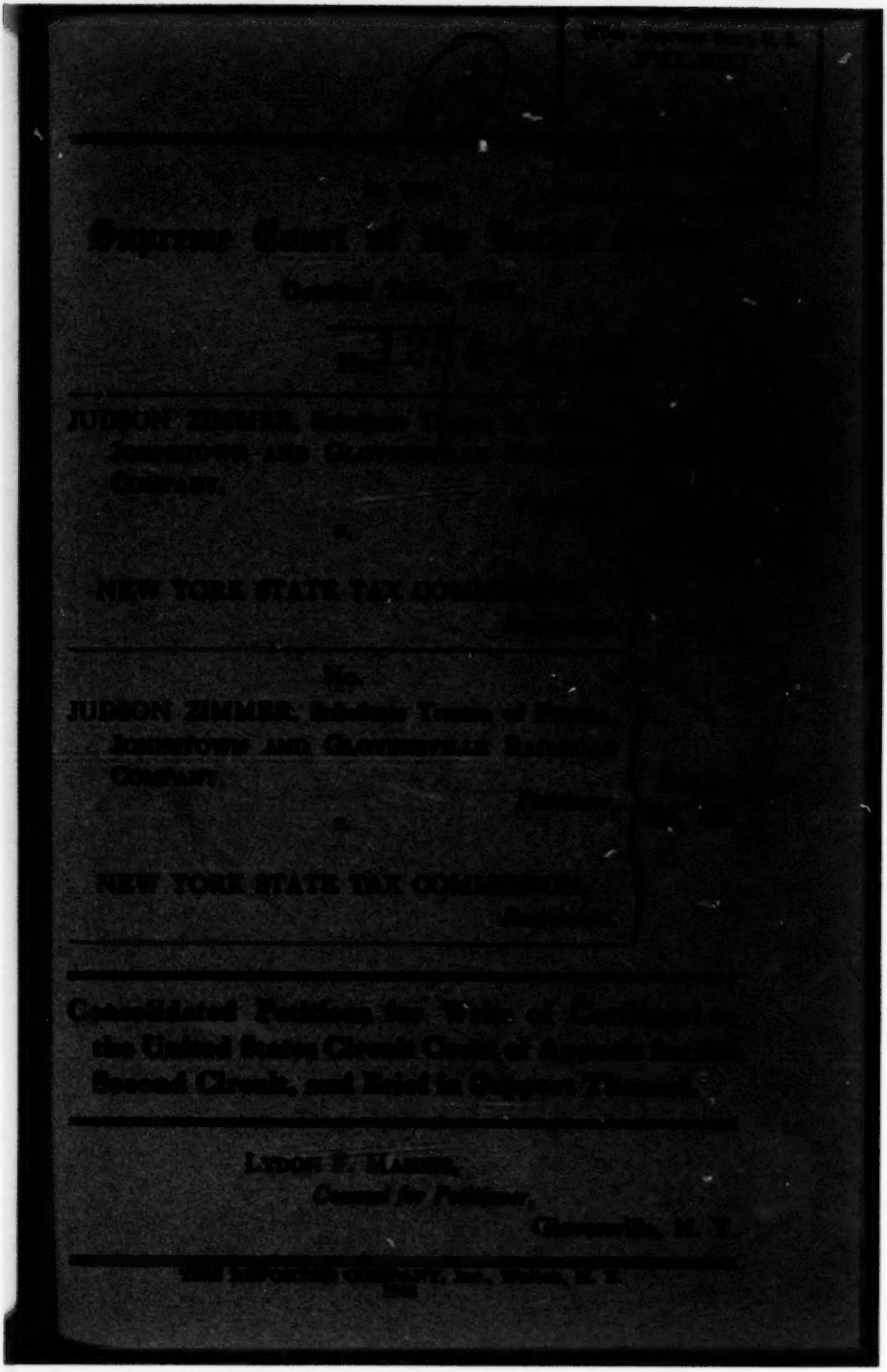

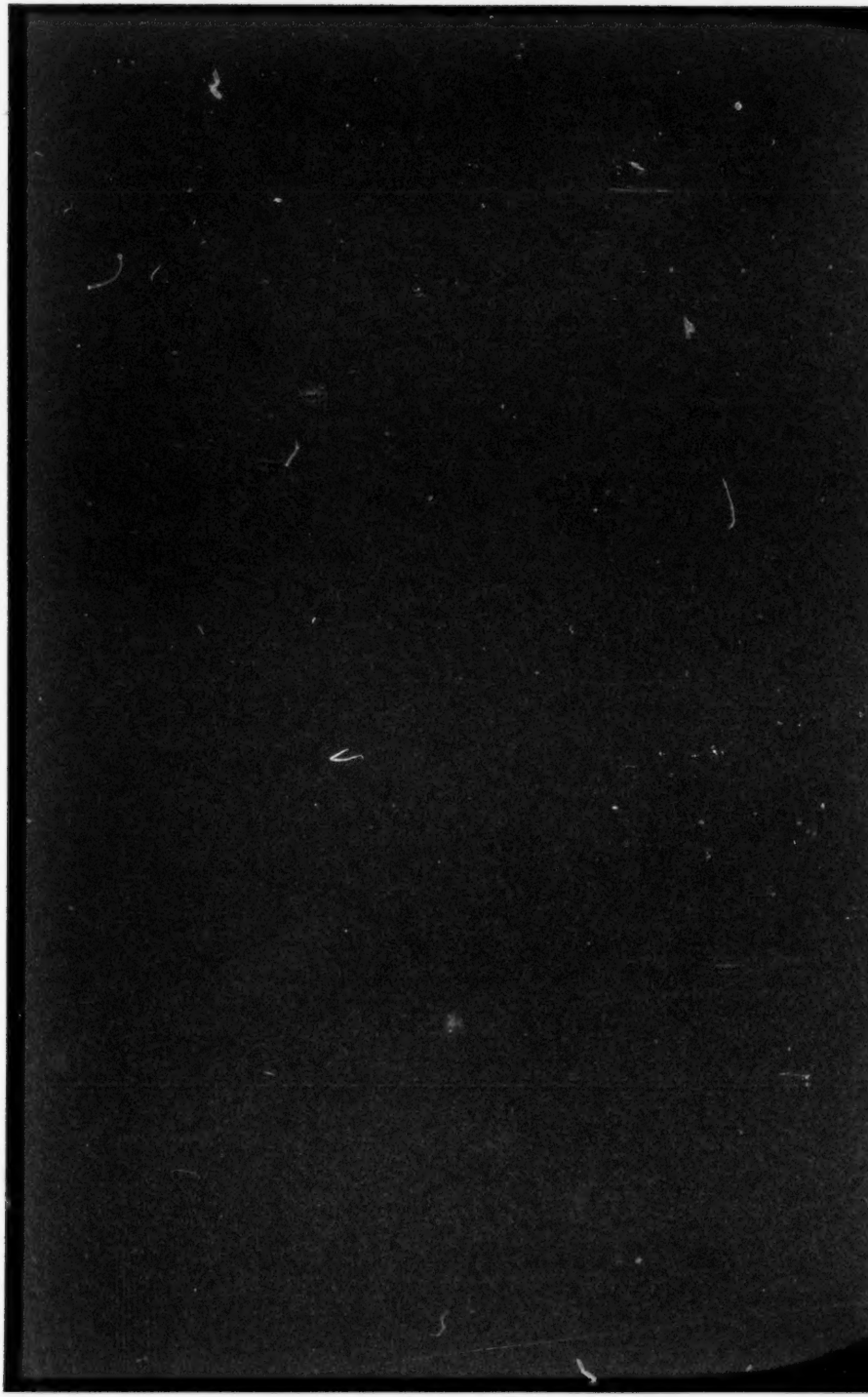

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IN THE

Supreme Court of the United States

October Term, 1941

No.

JUDSON ZIMMER, Substitute Trustee of Fonda, Johnstown and Gloversville Railroad Company,

Petitioner,

v.

NEW YORK STATE TAX COMMISSION,

Respondent.

Order No. 168

No.

JUDSON ZIMMER, Substitute Trustee of Fonda, Johnstown and Gloversville Railroad Company,

Petitioner,

v.

NEW YORK STATE TAX COMMISSION,

Respondent.

Order No. 169

Consolidated Petitions for Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit, and Brief in Support Thereof.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Judson Zimmer, Substitute Trustee of Fonda, Johnstown and Gloversville Railroad Company, Debtor, prays that writs of certiorari issue to review the orders or judgments of the Circuit Court of Appeals for the Second Circuit, entered in the above causes on the 25th day of March, 1942, by which the claims of the State of New York against him and his predecessor (J. Ledlie Hees, Trustee) for franchise taxes under Sections 183 and 184 of the Tax Law of the State of New York were allowed for periods subsequent to April 20, 1933, the date of the commencement of the trusteeship, thereby affirming in part and reversing in part the orders of the District Court for the Northern District of New York.

These petitions are consolidated in the interest of conserving the time of the Court, and of economy inasmuch as the parties are the same, and the facts, as will more fully appear, while differing in some important aspects, are basically similar.

A. Summary statement of the matters involved.

Fonda, Johnstown and Gloversville Railroad Company, a New York corporation, filed its petition pursuant to Section 77 of the Acts of Congress relating to Bankruptcy on the 20th day of April, 1933. On that day the petition was approved as properly filed and J. Ledlie Hees was appointed Trustee of the Debtor's estate. His appointment was terminated on June 27, 1940, at which time petitioner was made Substitute Trustee by the order of the Court. (W. R. p. 13, G. R. p. 10. See footnote.)

Note: "W. R. refers to the Transcript of Record in the United States Circuit Court of Appeals on appeal from Order No. 168, which is printed in the white cover. "G. R." refers to the Transcript of Record in the United States Circuit Court of Appeals on appeal from Order No. 169, which is printed in the gray cover.

Fonda, Johnstown and Gloversville Railroad Company (hereinafter referred to as "Debtor") is a New York corporation which was created in 1902 as the result of the consolidation of three previously existing New York railroad corporations (G. R. p. 9).

For many years prior to April 20, 1933, the State of New York, for the privilege of exercising corporate franchises or carrying on business in the corporate or organized capacity within the State, imposed taxes on corporations commonly known as "franchise taxes." For railroad corporations, in which class the Debtor was included, the applicable provisions of the Tax Law were Sections 183 and 184 (McKinney's Consolidated Laws of New York Annotated at pages 396 and 401).

Section 183, excluding inapplicable words, reads as follows:

> "* * * For the privilege of exercising its corporate franchise or of holding property in this State every domestic corporation * * * formed for or principally engaged in the conduct of * * * railroad * * * business * * * shall pay, in advance, an annual tax to be computed upon the basis of the amount of its capital stock within this State during the preceding year, and upon each dollar of such amount * * *."

The amount of the tax is specified as being a minimum of not less than $10 nor less than one mill on each dollar of the net value of its issued capital stock which shall have a minimum value of not less than $5 per share.

Section 184 is denominated an "Additional Franchise Tax" and, excluding inapplicable words and phrases, reads:

> "Every corporation * * * formed for or principally engaged in the conduct of * * * surface

> railroad * * * business * * * shall pay for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this State, an excise tax or license fee which shall be equal to five-tenths of one per centum upon its gross earnings from all sources within this State * * *."

Subsequent to the commencement of the trusteeship the New York State Tax Commission filed with the Trustee claims for franchise taxes under Sections 183 and 184. The Trustee made a motion in the District Court to expunge these claims. Order No. 168 (W. R. p. 10) of the District Court allowed certain of these claims and expunged others. The table which follows indicates the result in the District Court and in the Circuit Court:

Provision of Tax Law	Period	Amount	District Court		Appealed to Circuit Court of Appeals	Circuit Court of Appeals
No. 1. Sec. 183	Beginning 1/ 1/33	$ 628.29	Allowed		No appeal	----
No. 2. Sec. 184	Year ending 6/30/32	2,301.59	Allowed		No appeal	----
No. 3. Sec. 183	Beginning 1/ 1/33	3,164.19	Expunged		No appeal	----
No. 4. Sec. 183	Beginning 1/ 1/34	3,106.20	Expunged		Appeal by State	Reve
No. 5. Sec. 184	Year ending 6/30/34	1,883.55	Allowed Expunged	61.92 1,821.63	Appeal by Trustee Appeal by State	Affirm Reve

The effect of the Act of June 18, 1934 (Section 124-a U. S. C. A. Title 28) was pertinent with respect to Item No. 5 and accounted for its allowance in part. The Act of June 18, 1934, purported to make Trustees appointed by United States Courts who were authorized to conduct any business, subject to "all state and local taxes applicable to such business the same as if such business were conducted by an individual or corporation." (See Brief p. 25 for the statute set out *in extenso.*)

The Trustee contended in the District Court and in the Court below that Section 77 of the Bankruptcy Act and the order appointing Trustee (W. R. p. 19) conferred title on a bankruptcy Trustee and inasmuch as his operations were conducted by virtue of the Act of Congress and the order of appointment and conversely not by virtue of the sovereign authority of the State of New York to grant corporate franchises, the event by which taxation was intended to accrue under the statute had not taken place and accordingly he was not liable for the taxes.

The Circuit Court of Appeals was of the opinion that irrespective of the Act of June 18, 1934, the Trustee was liable under New York Law for franchise taxes accruing under Sections 183 and 184 of the Tax Law. The District Court's order was accordingly reversed insofar as it expunged and disallowed Item No. 4 and a part of Item No. 5, and was affirmed insofar as the District Court's order had allowed Item No. 5 in part (Opinion, W. R. p. 52, 126 Fed. 2nd 606).

The State Tax Commission had filed similar claims for franchise taxes under the same statute for periods subsequent to those involved in the proceedings just outlined (G. R. p. 13 *et seq.*). The Substitute Trustee made a similar motion in the District Court to expunge these claims and in addition, to enjoin the filing of similar claims in subsequent years (G. R. p. 7). This motion was denied in every respect and resulted in Order No. 169 (G. R. p. 5) an appeal from which was prosecuted to the United States Circuit Court of Appeals where the order of the District Court was unanimously affirmed (Opinion, G. R. p. 71, 126 Fed. 2nd 604). The reasoning of the Court below will be discussed hereinafter.

B. Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, the Act of March 3, 1891, c. 517, 26 Stat. 828, as amended by the Act of February 13, 1925, c. 229, 43 Stat. 938.

C. Questions presented.

1. Prior to the Act of June 18, 1934 (Section 124-a, U. S. C. A. Title 28) did a bankruptcy Trustee operating a railroad under Section 77 of the Bankruptcy Act *in fact* exercise the privileges of the Debtor corporation specified in Sections 183 and 184 of the New York Tax Law as being the events upon which taxability resulted and *if not,* should he have any liability to pay taxes computed according to the measures indicated?

2. Prior to the Act of June 18, 1934 (Section 124-a, U. S. C. A. Title 28) did Sections 183 and 184 of the New York Tax Law impose upon a bankruptcy Trustee operating a railroad under Section 77 of the Bankruptcy Act, the liability for a license fee for the privilege of exercising the Debtor's corporate franchise?

3. If the answers to questions numbers 1 and 2 are in the negative, did the Act of June 18, 1934, so change the character of a Trustee's operations, the New York Tax Law or the Bankruptcy Act so that thereafter he can be said to be exercising the privileges specified in Sections 183 and 184 which result in taxability?

4. If the answers to questions numbers 1, 2 and 3 are in the negative, in the absence of an affirmative showing and finding of the necessity of preserving the Debtor's corporate franchise and a direct order by the Court so to do, can the taxes under Sections 183 and 184 be said to be proper expenses of administration?

D. Reasons relied upon for the allowance of the writs.

1.

The Circuit Court of Appeals has decided an important question of local law probably in conflict with applicable local decisions.

The effect of the decisions below is to decide that Sections 183 and 184 of the Tax Law impose a tax on the operator of a railroad property whether or not the franchise "to be" or "to do" is used. The New York Courts have uniformly and for many years held that the many New York franchise taxes are upon the *privilege* exercised and *not* upon the *measure* chosen. See *People v. Miller,* 177 N. Y. 51. If the franchise is not utilized there is no liability, as where an assignee for the benefit of creditors operates a business. *Matter of Heilbron, Wolf & Co., Inc.,* 224 App. Div. 14. And see *In re Century Silk Mills,* 12 Fed. (2nd) 292 (D. C. N. Y.); *In re Continental Candy Co.,* 291 Fed. 773 (D. C. N. Y.). A bankruptcy Trustee operating a property is in the same class with an individual operating on his own responsibility and for his own account.

The Circuit Court's distinction between a liquidating Trustee and a "conserving" trustee was never sanctioned by the New York Courts. It will be fully discussed in the brief, Point I.

2.

The Circuit Court of Appeals has decided an important question of Federal Law which has not been but should be settled by the Court.

The basis for Section 77 of the Bankruptcy Act and many of its effects have been set at rest by *Ex Parte Bald-*

win, 291 U. S. 610; *Continental Ill. N. B. & T. Co. v. C. R. I. & P. R. Co.*, 294 U. S. 648; *Lowden v. Northwestern Nat. Bank & T. Co.*, 298 U. S. 160; *Palmer v. Massachusetts*, 308 U. S. 79; *Warren v. Palmer*, 310 U. S. 132, and other cases.

The present decision is a challenge to the authority of the Federal Government to enact bankruptcy legislation. In effect it means that the operations of a bankruptcy Trustee are dependent upon the sovereign power of the States which may grant, deny or take away or condition the exercise of the corporate existence of the Debtor, upon payment of so-called franchise taxes or license fees, and hence directly affect the bankruptcy power. If, as must be the fact, the termination of the corporate existence of the Debtor by New York State, would not impair the trusteeship or the District Court's jurisdiction, the Circuit Court's position must be untenable.

The decision of the Court in *Michigan v. Michigan Trust Co.*, 286 U. S. 334, and denial of certiorari in *Wick, et al., v. State of New Jersey*, 306 U. S. 648, do not affect this statement as will be fully pointed out in the brief.

If in certain cases, franchise taxes should be paid by Trustees under Section 77 of the Act, as the Circuit Court of Appeals for the Eighth Circuit decided in *Thompson v. Louisiana*, 98 Fed. (2nd) 108, the principle contended for here would not be in conflict. There probably are instances where the preservation of the franchise would be of value to those interested in the estate. The *Thompson* case appears to be such a case. *There are no facts in the case at bar which lead to the conclusion that the preservation of the Debtor's existence will be of value.* (See brief.) It should be established when and under what circumstances the Court having control of the estate should order the expenditure of cash to preserve the corporate franchise of the Debtor.

The foregoing statement is equally applicable to the situation after the enactment of the Act of June 18, 1934. It should be decided whether or not that Act has the effect of changing the tax laws of the States so that, from that date onward, subjects of taxation not covered by the taxing statute could be regarded as being taxed. Compare *Boteler v. Ingels*, 308 U. S. 57, where the privilege tax applied to all users of the highway. The Act of June 18, 1934, if there were any question as to the immunity of Trustees from taxation *otherwise applicable to them*, as apparently there was in some jurisdictions, removed immunity. And contrast R. S. 5219 where the States were permitted to tax national banks. (See brief, Point III.)

The real question for decision is whether the Act of June 18, 1934, was more than permissive in effect. Did it actually modify New York State legislation? As striking as this question may be, such is the effect of the decision of the Circuit Court.

3.

The Circuit Court of Appeals decided the case at bar by applying a construction of the Act of June 18, 1934, probably in conflict with decisions of this Court.

The following is quoted from the opinion of the Court (G. R. p. 73):

> "The court below ordered that the taxes which had been assessed under Sections 183 and 184 should be paid as expenses of administration pursuant to the Act of June 18, 1934. While the matter is not free from doubt, the decisions of the Supreme Court in *Michigan v. Michigan Trust Co.*, 286 U. S. 334; *Boteler v. Ingels*, 308 U. S. 57, and *Palmer v. Webster & Atlas Bank*, 312 U. S. 156, 163, seem to indicate that franchise taxes imposed upon a corporation both for doing business and for being a

> corporation are proper charges against either a receiver or a trustee at least unless the trustee be only one in dissolution of the company."

Michigan v. Michigan Trust Co., decided prior to June 18, 1934, had held that an equity receiver was liable for Michigan franchise taxes similar to those of the State of New York because the event upon which taxability was predicated, namely, use of the franchise, actually took place. The Michigan Court had decided this fact. But neither *Boteler v. Ingels* nor *Palmer v. Webster & Atlas Bank* nor the principles upon which they rest, support the contention that an operating bankruptcy trustee is subject to franchise taxes after June 18, 1934. In point of fact, both would seem to support the contrary view, namely, that the Act of June 18, 1934, is not to be applied indiscriminately and without regard to the effect of tax payment on the estate and its creditors. The decision of the Court below is also inconsistent with *Philadelphia Co. v. Dipple*, 312 U. S. 168, for the same reasons. (Brief, Point III.)

WHEREFORE, your petitioner respectfully prays that writs of certiorari issue out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and of all proceedings in the cases entitled, "In the Matter of Fonda, Johnstown and Gloversville Railroad Company, Debtor (In Proceedings for the Reorganization of a Railroad), Judson Zimmer, Substitute Trustee, etc., Appellee-Appellant, New York State Tax Commission, Appellant-Appellee (Order No. 168)," and "In the Matter of Fonda, Johnstown and Gloversville Railroad Company, Debtor (In Proceedings for the Reorganization of a Railroad), Judson

Zimmer, Substitute Trustee, etc., Appellant, New York State Tax Commission, Appellee (Order No. 169)," to the end that said causes may be reviewed and determined by this Court as provided in Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. A. 347), and the Rules of this Court, and that your petitioner may have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity with the provisions of the said Code and the Rules of this Court, and that judgments of the Circuit Court of Appeals may be reversed by this Court.

JUDSON ZIMMER,
Substitute Trustee of Fonda, Johnstown and Gloversville Railroad Company,
Petitioner.
By LYDON F. MAIDER,
Attorney for Petitioner.

Gloversville, N. Y., April 15, 1942.